

EMPLOYEE PENSION PLANS

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Twentieth century business has produced many kinds of employee benefit programs. Today it is a common practice for an employer alone or jointly with his employees to provide hospitalization and medical benefits, disability payments, death benefits, illness and accident benefits, unemployment protection, and retirement income for the employees. Most of these benefits have been furnished through the use of insurance. This article examines the ways insurance is used in one of the most important phases of employee benefit programs—pension plans. Other employee benefits are often provided as incidental features of pension plans, and much of what is to be said in this article about insured pension plans applies as well to other employee benefit insurance.

I

GROWTH OF PENSION PLANS

Pension planning is a new and dynamic field. The most recent statistics released by the Pension Trust Section of the Bureau of Internal Revenue list approximately 13,000 Bureau-approved pension plans in operation.¹ Yet in 1930 less than 1 per cent of that number of plans were in existence,² and even as late as 1937 only 700 plans were in operation.³

A number of factors have worked together to bring about the phenomenal growth of pension plans. These factors will be considered briefly because the continued expansion of pension plans and the consequent use of insurance to fund them depends in large part on the continuation of these conditions.

High federal income tax rates and the very favorable provisions of the revenue code allowing a deduction for payments to qualified pension plans were probably the most important factors in the growth in the number of pension plans. The Internal Revenue Code permits deductions for payments made to a plan that meets the requirements of the code and regulations concerning such specifications as the number and type of employees covered and the fairness of the provisions.⁴ These features of the plan must be approved by the Bureau of Internal Revenue before a

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¹ Fortune, Nov. 5, 1949, p. 81, col. 2. For a statistical analysis of 6,862 plans approved prior to August 31, 1946, see PENSION TRUST STATISTICAL TABLES, BUREAU OF INTERNAL REVENUE.

² Fortune, Nov. 5, 1949, p. 81, col. 2.

³ Lipton, *Insured Plans* in TRENDS IN RETIREMENT PLANNING 18 (American Management Ass'n, Ins. Ser. No. 73, 1948).

⁴ INT. REV. CODE §23(p)(1)(A), (B), and (C). For a discussion of federal estate and gift tax aspects of employee benefit plans, see Note, 48 COL. L. REV. 393 (1948).

plan is termed "qualified."⁵ The influence of tax considerations on pension plan growth is borne out by the fact that 85 per cent of the plans now in existence were inaugurated after 1942,⁶ the beginning of high corporate taxes. Management's incentive to provide pensions increases as corporate income taxes increase. If pension payments are deductible for income tax purposes, and profits are taxed at, say, 70 per cent, then a pension dollar will cost the employer only thirty cents and the government in effect pays the other seventy cents through the allowable deduction. It is true that an employer does not have to contribute to a pension plan qualified with the Bureau in order to claim a deduction for his pension spending. Payments to employees already retired will be deductible as long as they are reasonable.⁷ But the qualified pension plan has additional tax advantages. The earnings from the fund are not subject to taxation, *i.e.*, the increase of the fund from investments under trustee plans or from the enhanced value of annuity purchases in insured plans is not taxed.⁸ Therefore, under a qualified plan, the employer during the working life of an employee can accumulate tax free a good portion of the money necessary to retire his employee.

There is, in addition, an important tax advantage to an employee in that taxation of funds paid into a qualified plan for his benefit is postponed until he receives it on retirement.⁹ Presumably his income will be lower during years of retirement, and consequently the funds will be taxed at a lower rate. This is particularly important to the high salaried employees. The tax advantage to corporate officials has no doubt been a strong incentive for such officers to favor pension plans. There is another peculiar advantage to the management of a closely held corporation. As suggested above, a corporation in the high income bracket pays from corporate profits only a small part of the cost of funding a pension plan. If the corporate executives are also substantial stockholders, and provide pension benefits for themselves, it is conceivable that a plan may be devised that in net effect costs the management nothing. The payments out of profits can be drawn from the fund by way of retirement benefits to the stockholder-officials.¹⁰

The entrance of insurance companies into the pension field in the late Twenties had much to do with the growth of pension activity.¹¹ Before that time, pensions were for the most part on an informal basis. The employer retired his employees

⁵ Among the requirements listed in INT. REV. CODE §165(a) for qualifying a plan are: If a trust is used it must be irrevocable; the plan must be exclusively for the benefit of the employees; the plan must not be discriminatory.

⁶ *Fortune*, Nov. 5, 1949, p. 81, col. 2. For a comparison of the number of employees covered by plans in 1942 and 1946, see Gardner, *Trusted Plans* in TRENDS IN RETIREMENT PLANNING 73 (American Management Ass'n, Ins. Ser. No. 73, 1948).

⁷ INT. REV. CODE §23 (P)(1)(D).

⁸ *Id.* §165(a).

⁹ *Id.* §165(b).

¹⁰ COCHRAN, HONEST EMPLOYEE BENEFIT PLANS WITH NO NET COST TO OWNER-MANAGEMENT (Pamphlet, 1949).

¹¹ On the growth of insurance company activity in pension planning, see, generally, HUGH O'NEILL, MODERN PENSION PLANS: PRINCIPLES AND PRACTICES 37 (1947).

and provided pensions wholly as a matter of discretion. Insurance companies offered a method of guaranteeing retirement benefits by the use of group annuities, and the funds necessary for pensions could be accumulated on a sound basis while the employee was still working. The latter arrangement was much more satisfactory than leaving the payment dependent on business conditions at the time the employee reached retirement age. The employee of course was much happier if the employer provided a formal, guaranteed pension program. No doubt insurance companies' advertising the advantages of formal pension systems, and their ability and willingness to design pension systems and to advise on pension problems did much to stimulate interest and activity in pensions.

Numerous other factors have contributed to the increase in pension plans. The Social Security Act¹² stimulated the interest of the public, particularly the interest of labor unions, in the problem of old age benefits.¹³ Wage stabilization legislation contributed to the multiplication of pension plans during the war.¹⁴ Retirement benefits were not within the ban of wage stabilization,¹⁵ and thus the attention of labor was drawn to pensions. Direct wages could not be increased, but pensions provided a way to enhance benefits flowing from employment.

That pension plans offer definite advantages to management is not to be overlooked in a consideration of the causes of pension growth.¹⁶ The fact that a number of employers established pension systems prior to the advent of those influences mentioned above, indicates that many employers felt the establishment of a pension system to be advantageous to the company in other ways.¹⁷ Pension systems enable the employer to retire superannuated employees rather than to retain them in their years of declining usefulness at proportionately high salaries. Employees are more apt to retire without ill will toward the employer when they have been advised in earlier years that they will be retired at a stipulated age with predetermined benefits. Much distrust and uncertainty is bred by a policy of retiring employees at different ages and allowing varying amounts as pensions. No doubt labor turnover is decreased in companies offering sound pension benefits. Young employees are given an opportunity to advance rapidly and are more likely to remain with the company because of this opportunity. Thus the organization remains young and energetic. Finally, public good will is cultivated by the employer who provides an attractive retirement program for his employees.

¹² 49 STAT. 620 *et seq.* (1935), 42 U. S. C. §§301 *et seq.* (1946).

¹³ For a discussion of the Social Security Act in connection with pension planning, see WINSLOW, PROFIT SHARING AND PENSION PLANS 130, 175 (1946).

¹⁴ Note, 43 ILL. L. REV. 713, 718 (1948).

¹⁵ 56 STAT. 768 (1942), 50 U. S. C. §970 (1946).

¹⁶ Cliffe, *An Employer's View on Pension Plans*, 84 TRUSTS AND ESTATES 288 (1947).

¹⁷ Willis, *Current Thinking on Employee Retirement Plans* in TRENDS IN RETIREMENT PLANNING 4 (American Management Ass'n, Ins. Ser. No. 73, 1948).

II

METHODS OF INSURING PENSION PLANS

Formal pension plans are normally funded through trusts or insurance.¹⁸ Under "trusteed" systems, funds are paid periodically to a trustee who makes investments and pays out income to qualified pensioners according to the trust instrument. In "insured" systems the program is underwritten and in most instances administered by an insurance company in return for periodic premiums. Perhaps it is not technically accurate to refer to many "insured" pension systems as part of the insurance field because most of these plans utilize annuities, and annuities are said not to be insurance;¹⁹ but for practical purposes annuities are part of the business of insurance. The great majority of annuities are written by insurance companies and, further, many insured pension plans utilize traditional forms of insurance.

Insured plans fall conveniently into the following categories, and will be discussed in the order given: (1) group annuities, (2) group permanent, (3) individual contracts, (4) ordinary life trusts, and (5) deposit administration. The various kinds of plans may be used in combination, but this division will serve for a discussion of the standard insurance finance methods.

A. Group Annuities

The group annuity²⁰ is the oldest and one of the most frequently used of the insured plans. Group annuities came into common use around 1925 and are responsible for many of the changes in pension thinking that have occurred since that time. The important feature to be noted in connection with a group plan is that one master contract is issued and the insurance company completely administers the system. The contract sets both the rights and duties of the employer, employee, and the insurance company. The insurance company invests the funds and pays out the benefits as they become due. Thus the employer is relieved of the responsibility both of investing the funds and of administering the benefits under the plan. A trustee is not necessary in this type plan.²¹ Insurance companies usually will not issue group contracts to cover less than fifty employees, and if the plan provides for contributions from the employees, participation by at least 75 per cent of the eligible employees is required.

¹⁸ For a comparison of the advantages of each method, see Hamilton, *Employee Benefit Plans: Trust or Insurance Facilities May Be Used*, 83 TRUSTS AND ESTATES 583 (1946). For a model plan under each method, see MacNeill, *Pension and Profit-Sharing Trusts*, 83 TRUSTS AND ESTATES 485 (1946).

¹⁹ EDWIN W. PATTERSON, *CASES AND MATERIALS ON INSURANCE* 36 n. 1 (2d ed. 1947).

²⁰ See, generally, FLEMING BOMAR ET AL., *HANDBOOK FOR PENSION PLANNING* 86 (Bureau of National Affairs, 1949); O'NEILL, *op. cit. supra* note 11, at 103; ROBERT RIEGEL AND JEROME S. MILLER, *INSURANCE, PRINCIPLES AND PRACTICES* 230 (3d ed. 1947); P-H PENSION AND PROFIT SHARING SERV. ¶2096 (1947); Hamilton, *supra* note 18; Waters, *Insured Pension Plans* in *TRENDS IN EMPLOYEE HEALTH AND PENSION PLANS* 12, 14 (American Management Ass'n, Personnel Ser. No. 118, 1948).

²¹ A trust may be used, and when only part of the benefits are funded through the use of a group annuity it may be necessary.

Each employee covered by the plan receives a certificate which outlines the benefits to which he is entitled. This certificate does not, however, make the employees parties to the contract. The contract is between the employer and the insurance company, although the employees, either individually or through their union, may have a contract with the employer to provide benefits.

Single premium deferred annuities are used in the group annuity plan. The annual premium each year purchases for every employee covered by the plan a small deferred annuity which represents the amount of pension credit attributable to that year's employment. The premium for an employee will increase each year. An annuity of one dollar per month for life to begin at age sixty-five is considerably more expensive for an employee fifty years old than for one forty years of age. The period during which the insurance company will be able to hold the premium and thus earn interest is shorter, and the chances that the employee will be living at age sixty-five to receive the annuity are much greater in the case of the older employee.

Death benefits ordinarily are not provided by a group annuity plan. The employee must live until the designated retirement age to receive any benefits from the program. Since the standard group annuity contract makes no provision for life insurance, the cost of the plan is reduced by the amount that would otherwise be paid to those who do not reach retirement age. The premium normally is discounted for this mortality. On the other hand, it is not the practice to discount in advance for employees who may be expected to sever their connection with the company. The employment relationship will of course be terminated in some instances before the employees reach retirement age, but the consequent reduction in cost of the annuity provides a credit against premiums currently due. Of course, this statement is based on the assumption that the plan is noncontributory²² and that vesting of rights to the employee have not occurred at the time the employee leaves employment. If the plan is contributory and the employee's rights are not vested by the time he leaves or is dismissed, his contributions are refunded, with or without interest depending upon the provisions of the particular plan. Obviously, when the employee's rights are vested there will be no credit on severance because the employee will be entitled to the benefits already accrued to him. In other words, upon reaching retirement age he will simply draw a pension based on the annuities purchased for him each year during his employment.

The group annuity contract is popular because of its low initial cost. New enterprises that expect greater income in later years are particularly apt to select that kind of plan. In the case of long-established businesses, there is the problem of past service benefits. In some instances no provision will be made for past service, whereas in others the employer either on his own initiative or as the result of bargaining with a union will decide to provide a pension based on past service. This

²² The fact that a plan requires contributions from the employees does not affect the method of funding. The same kind of insurance contract may be used to fund a contributory or noncontributory plan.

may be accomplished by simply supplementing the annuity plan on a pay-as-you-go basis upon the retirement of those employees who had past service to their credit at the time the annuity contract was initiated. Or the employer may purchase from the insurance company annuities for past service. Annuities for past service credits may be purchased at the time the plan is inaugurated or from time to time during the operation of the plan. The cost of an annuity will be more expensive if purchased some time after the service has been performed than it would have been if purchased during the years the service was rendered. The employee will be older and the cost of the annuity will have risen proportionately.

The employee beneficiary of a group plan is normally given an option to elect the type annuity payment he wants; the option to be exercised at least five years before he reaches retirement age. The kinds of annuity from which he may choose include the life annuity, annuity certain, and the joint and survivor annuity. Although the group plan generally does not provide for death benefits, if it requires contributions from the employee it usually provides for the refunding of his contributions with interest to his estate if he dies before reaching retirement age. This feature is probably necessary in order to sell the contributory plan to employees who have come to look on their contributions to pension programs as a mode of savings.

B. Group Permanent Plans

The group permanent plan²³ consists of a master policy or contract between an employer and an insurance company. The contract sets forth the rights and duties of the parties and normally provides for full administration by the insurer. Thus it is unnecessary to provide for a trustee under this type plan although it is possible to use the group permanent plan in connection with a trust.

This plan provides life insurance in addition to retirement benefits. The insurance features of the plan must qualify under state regulatory laws. As was true in the case of the group annuity plan, a group permanent plan is ordinarily not issued to a group of less than fifty employees; and if the plan is contributory, at least 75 per cent of the eligible employees must actually participate in the plan. The total insurance coverage is usually set at a \$250,000 minimum.

The amount of life insurance coverage provided for each employee varies proportionately to the amount of monthly retirement benefits. For instance, the standard policy offers \$1,000 of life insurance for each \$10 of monthly pension income. Therefore, if an employee covered by this plan is entitled to \$200 per month on retirement he will have \$20,000 of life insurance coverage. There is no magic in this particular formula, but it is used by most insurance companies. Some companies, however, provide for a smaller amount of life insurance for each \$10 of monthly pension.

An employee is automatically covered by the insurance on entering employment

²³ See generally, BOMAR ET AL, *op. cit. supra* note 20, at 116; O'NEILL, *op. cit. supra* note 11, at 231; RIEGEL AND MILLER, *op. cit. supra* note 20, at 234; P-H PENSION AND PROFIT SHARING SERV. ¶2131 (1947); WATERS, *supra* note 20, at 16.

and electing to participate in the plan. A medical examination is not necessary. There is, however, one exception to this automatic insurance coverage. The maximum amount of life protection issued to any one employee will be limited under each plan to a figure determined by the total amount of insurance carried under the plan and the average amount of insurance issued to the fifty employees who are to receive the largest insurance benefits. Even with this limit, 90 per cent of employees under plans in operation are covered by insurance without medical examination. If a particular employee is entitled to more insurance under the formula of \$1,000 to every \$10 of monthly retirement than is allowed by this automatic limit, he must establish his insurability to obtain the additional amount.

Group permanent insurance differs considerably from the ordinary group annuity in the type of premium paid. The level premium is commonly used in the group permanent plan. When an employee enters a plan, the cost of benefits will be ascertained and the same premium will be paid annually until his retirement. Generally the amount of retirement income an employee will receive is determined by the amount of his wages. Suppose that a plan provides that an employee earning \$5,000 annually shall receive \$110 monthly retirement benefits. According to the insurance formula discussed above, this employee would be entitled to \$11,000 life insurance ($1,000 \times 11$). When this employee entered the plan a level annual premium adequate to provide the above benefits would be set. In other words, the group permanent plan will cost just as much to fund in the earlier years of the plan's operation as it will in later years, whereas the ordinary group annuity, as has been mentioned, is less expensive at the inception of the plan.

Under the group permanent plan if an employee dies during the early years of participation in the plan before reaching retirement age, his beneficiary receives the face amount of his insurance. If death occurs nearer retirement, the beneficiary receives the cash value of the plan. In other words, when the cash value exceeds the face value of an employee's coverage, the former amount will be paid. The point at which the cash value will be greater than the \$1,000 per \$10 retirement income face amount will vary with the age of the employee on entering the plan and the number of years he is covered. Generally the beneficiary is given an option to take the insurance in a lump sum, leave the insurance proceeds drawing interest with the insurance company for a certain period, or take a life annuity.

On reaching retirement age, the employee has an option as to the type benefits he will receive. Among the choices are usually the life annuity with a certain minimum period guaranteed (generally five or ten years) and the joint and survivorship annuity that pays a certain monthly income to the employee and, in the event of his prior death, to the named survivor.

Group permanent plans are particularly desirable because of their adaptability on severance of employment prior to the employee's reaching retirement age. The rights of the employee on termination of employment will vary depending on whether the cost has been borne entirely by the employer or by both employer and employee,

and whether the contributions made on behalf of the employee by the employer have become vested under the particular plan. Again, not all plans provide for the same options to the employee on severance. The following are some of the elections offered under various plans: (1) the cash value of premium payments that have become vested in him; (The employer will receive a credit for any amount not reflected in the cash value paid to the employee.) (2) total contributions with or without interest; (3) conversion to an individual policy without requiring proof of insurability; and (4) paid up insurance for the past premiums.

C. Individual Policy Trust

Pension plans insured through the purchase of individual insurance policies and annuities²⁴ generally though not necessarily use the facilities of a trust. The provisions of the plan are separate and apart from the contracts with the insurance companies. The trustee has the responsibility of applying to the insurance company for the individual policies. Premiums are collected from the employer by the trustee and paid to the insurance company. It is common to provide that the receipts from the policies shall be paid to the trustee and distributed to entitled employees by the trustee. In some plans, however, payment is made directly to the eligible employees by the insurance company. Since most individual plans provide for life insurance and some insurance companies require that life coverage be included, the employee must establish his insurability. This feature is one important point of difference between an individual policy trust and a group plan. Some insurance companies do issue individual policies without a medical examination. The employees are required to answer certain questions on the application about their health. If the answers do not raise a question as to the employees' insurability, the policy will be issued without medical examination. As in the case of the group permanent plan, the amount of life insurance provided in the individual policy is \$1,000 coverage for each \$10 of monthly retirement income. Since a separate policy is purchased for each individual, a trust may buy from several different insurance companies. The individual contract plan is particularly adaptable to the use of an employer with only a few employees, although it is not unusual to find this type plan in operation in large enterprises.

Premiums for the individual policy plan are paid on an annual basis and are a level amount. The premium on a policy covering a particular employee will be determined when the policy is issued and will remain the same (*i.e.*, there will be no rate changes) unless because of salary increases the amount of benefits is raised by the provisions of the plan and more coverage is purchased. Thus the rate is set for certain benefits when the employee enters a plan, but the trust has no guarantee that the same rates will be available for new employees entering at a later date. Insurance companies generally will not offer an individual policy which pays retirement benefits before ten years from the date of purchase have elapsed. Because

²⁴ See, generally, BOMAR ET AL, *op. cit. supra* note 20, at 128; O'NEILL, *op. cit. supra* note 11, at 136; P-H PENSION AND PROFIT SHARING SERV. ¶2111 (1945).

some employees will reach the normal retirement age less than ten years after the purchase of their contract, individual contract plans provide for a flexible retirement date. For example, an employee 58 years old entering a plan probably could not retire before reaching age 68, even though the usual retirement age under the plan is 65. Most insurance companies will not permit an increase of benefits (and premiums) due to the employee's reaching a higher salary bracket, unless it equals or exceeds a minimum amount in monthly retirement income—\$5.00 being the most usual figure.

Usually an individual policy plan where no life insurance is provided refunds the employee's contributions at his death. If the plan gives life insurance protection, the face amount will normally be paid to the named beneficiary. Some plans, however, provide that only a portion of the death benefits shall be paid to the beneficiary, the balance being used to pay the premiums on other policies held by the trust. Where all or a portion of the death benefits are payable to an employee's beneficiary, the usual options as to the mode of payment are available.

If the plan is contributory, termination of employment prior to vesting of the employee's right to benefits attributable to the employer's contributions usually results in a refund of the contributions of the employee. Under the same circumstances, other plans permit the employee to purchase the policy by paying the difference between the cash surrender value and the contributions he made during employment. If the employee's rights are vested on termination of employment, some plans give the employee full ownership of the policy, the premium rate remaining the same as when his contract was originally issued by the insurance company. The pension plan may restrict the employee's rights more than does the individual contract.

The employee under an individual policy plan is generally given an option among several types of retirement income similar to the choices offered under the other annuity plans. In the individual contract plan, however, the election may generally be made at the time of retirement and without medical examination.

If the trust purchases individual contracts from a mutual company, the policy will generally be of a participation type, *i.e.*, the trust will be entitled to dividends if the insurer operates at a profit. This factor is to be considered in determining the cost of a program. Ordinarily an insurance stock company will not issue participating policies, but their premium rates are apt to be initially lower.

D. Ordinary Life Policy Plan

One of the more imaginative uses of insurance in connection with pensions is funding through the purchase of ordinary life insurance policies.²⁵ An individual or corporate trustee is created to administer the program. The trust is authorized to purchase life insurance on all insurable employees to be covered by the plan.

²⁵ See, generally, BOMAR ET AL., *op. cit. supra* note 20, at 133; P-H PENSION AND PROFIT SHARING SERV. §2153 (1949).

Generally the contract with the insurance company guarantees certain rates of conversion when those insured reach retirement age, although it does not guarantee that the premium rates at the time of the plan's inauguration will be available to employees later coming under the plan. While the life policy is payable to the employee's named beneficiary, the trust owns the policy. When the employee reaches retirement age, the trustee converts the life policy into an annuity policy, the conversion being equivalent to purchasing an annuity with the cash surrender value at retirement age. The trust is not obligated to secure the annuity from the life company issuing the original policy, though of course it will do so if the conversion rate is then less than the market price of such an annuity.

The cash surrender value cannot be expected to furnish enough funds to purchase an annuity sufficiently large for the amount of life insurance that has been carried. It is necessary for the trust to accumulate additional funds to finance that part of the cost of the annuity in excess of the cash surrender value of the life policy. The annual contribution to this fund can be actuarially determined by taking into consideration the size of the group and their life expectancies.

If the employees to be covered meet the qualifications for group insurance, group permanent ordinary life contracts rather than individual ordinary life policies may be used to fund the plan. The group plan affords such additional advantages as lack of medical examination and lower costs of administration. Where the plan is on an individual policy basis rather than on a group basis, the trust is usually authorized to purchase individual annuity contracts for uninsurable employees. While the policies offered under the group permanent and the individual policy trust plans are so designed that the cash surrender value will at some time exceed the life insurance protection afforded, the cash surrender value of a policy under the ordinary life policy plan will never equal its face value.

Under some plans, an annuity is purchased for an employee when he reaches retirement age; others give him an opportunity to make an election of one of several types of annuities. If the employee dies before retirement, his beneficiary will receive the proceeds of the life insurance policy. If employment is terminated prior to retirement, the life policy is ordinarily turned over to the employee. In either event, the amount accumulated in the trust to pay the additional cost of the annuity will normally remain in the trust to reduce the cost of operating the plan, either because computation of the extra cost allowed for mortality and early severance or because the plan did not provide for the vesting of these funds in the employee until retirement age. The terms of each plan may differ, and what the employee receives on death before retirement or on termination of employment may well depend on whether the employee has been required to contribute to the plan.

E. Deposit Administration Plans

The deposit administration plan²⁶ is really a type of group annuity, but it

²⁶ See, generally, BOMAR ET AL, *op. cit. supra* note 20, at 114; O'NEILL, *op. cit. supra* note 11, at 235 n. 2; P-H PENSION AND PROFIT SHARING SERV. ¶2158 (1949).

is considered separately because a number of its features differ materially from the ordinary group annuity plan. Although premiums are paid to an insurance company annually, annuities are not actually purchased until particular employees retire. At the time of an employee's retirement, a single premium annuity to commence at once is purchased. The annual deposit payments to the insurance company are placed in an undivided separate fund. Most insurance companies guarantee a stipulated rate of interest on deposits made during the first five years under the plan, this rate of interest to continue on those particular funds as long as they remain on deposit. The insurance company may set a different rate of interest on funds deposited after the expiration of the five year period. The principle of "first money paid in is the first money to be paid out" is used to determine what interest rate is to be paid on various amounts in the fund each year. Generally the insurance company undertakes to sell the annuities at a stipulated price (*i.e.*, a set scale of premiums) when funds deposited during the first five years of the plan, plus accumulated interest, are converted into annuities.

The insurance company sets a maximum and minimum annual premium between which the employer may exercise discretion as to the amount of his deposit. This variation is allowed because no actual policies are sold until employees retire and, therefore, actual experience of mortality and severance may differ from estimated experience. Thus, the employer may use calculations based on past experience with the employees covered as long as this calculation comes within the limits set by the insurance company. The deposit administration plan may be used under a program to which employees contribute; but if the plan calls for employee contributions, a separate account of the funds contributed by each employee must be kept. The noncontributory deposit administration plan is less expensive to operate than the other types of plans discussed because under it separate records of annual annuity purchases for each employee need not be kept. If the deposit plan is contributory, however, the necessity of keeping individual employee records causes much of the advantage to be lost.

The deposit administration plan is much more flexible than other types of insured plans. Since annuities are not purchased until the employee is actually retired, the plan may provide for varying retirement ages, and a flexible scale of retirement income may be used. The employer's annual payment to the fund is generally based on what would be the average retirement date and average scale of retirement income under the plan. Actual experience under the plan may vary from these estimated averages. Since the money in the fund at a particular time is not allocated to the purchase of an annuity for any particular employee, the plan must provide for the distribution of the fund on hand in case the plan is discontinued.

The deposit administration plan gives an employer much of the flexibility to be had under an uninsured trust, but also the employer assumes more risks in this plan than he does under the other types of insured plans discussed.

III

FUTURE OF PENSION PLANS

Although the number of plans now operating is impressive, pension plans actually are still in the early stages of development. Only about one-tenth of the persons gainfully employed in the United States are at present covered by private pension systems. The possibility of further pension growth is sharply pointed up by comparing the number of companies that now have pension plans to the 40,000 organizations carrying group life insurance for their employees.²⁷

In considering the possible continued expansion of pension programs, the tax aspects must be taken into account. The decrease in the rate of corporate taxation since the removal of the excess profits tax²⁸ no doubt has had a tendency to slow up the adoption of pension plans. The decreased influence of taxation, however, has probably been counterbalanced by other factors. While future tax rates cannot be safely predicted, a drastic change of tax rates is not probable. Also, it is unlikely that any changes will be made concerning the provisions of the revenue code exempting pension fund income from taxation and postponing taxation of the employee until he receives benefits under the plan.

One of the most important questions encountered in attempting to prophesy about the future of private pension programs (and thus the business of insuring those programs), is whether the Federal Government will undertake to provide social security benefits substantially larger than it now provides or whether it will continue to assure only minimal security and leave the more substantial programs to private industry. In view of the present trend of social legislation, it is not beyond the realm of possibility that the government will undertake to provide a system of full scale benefits for employees.²⁹ The preempting of the pension field by government would of course practically eliminate pension insurance by private companies.

The Federal Government is presently subsidizing private pension programs by allowing deduction of payments to pension plans as expenses, by exempting income from pension funds from taxation, and by favorable tax treatment of employees covered by a plan. Private industry, by proper handling of the problem of security for superannuated employees, may prevent further moves toward the socialist state.

The attitude of labor unions toward pension plans has undergone almost a complete reversal in recent years. In the early period of employer-initiated plans, the unions generally opposed such plans because they felt that pension plans would weaken the position and growth of unions. Union officials felt that pension plans would be tied in with company unions, that strikes would be discouraged, that employees would be afraid to leave their employment because of the possibility of losing pension rights, and that the security promised by pension plans probably

²⁷ Lipton, *supra* note 3.

²⁸ Revenue Act of 1945, §122(a), 59 STAT. 568 (1945).

²⁹ At present only 35,000,000 of the nation's 60,000,000 employees are covered by social security. *Newsweek*, Mar. 20, 1950, p. 60, col. 1.

was illusory anyway because the plans were not insured. The federal courts have held that pension plans are a proper subject for collective bargaining.³⁰ This determination will, no doubt, prove important to the future adoptions of retirement programs. The pension plan is no longer a gratuitous undertaking by the employer, but is a benefit for which employees are entitled to bargain collectively just as they bargain for wage increases. Today the unions not only do not oppose pension plans furnished by the employer but on all fronts they are insisting that it is the responsibility of management to provide such programs.³¹

Certain long range considerations indicate that pension plans will continue to expand. Among these factors are: (1) the movement of agricultural workers to the cities and to employment in a rapidly expanding industrial economy, (2) the increase in the age level of the population, (3) the low interest rate on investments, and (4) the increase in personal income taxes.³² These factors render it impossible for the great majority of workers to provide for themselves satisfactory old age security.

³⁰ *Inland Steel Co. v. National Labor Relations Board*, 170 F. 2d 247 (7th Cir. 1948), *cert. denied*, 336 U. S. 960 (1949); Note, 43 ILL. L. REV. 713 (1948).

³¹ *Newsweek*, Jan. 31, 1949, p. 56, col. 1.

³² O'Neill gives the following example: An employee aged 40 earning \$10,000 per year and investing \$3,000, in 1929 could accumulate \$146,000 by the time he reached age 65. This capital would have provided him with an income of \$7,300, which would enable him to retain his previous standard of living during his years of retirement and still be able to leave the capital in his estate on death. A comparison is made with the accumulation possible in 1945 under the same conditions. It then appears that he will be able to accumulate only \$37,000, which would give him an annual return during retirement of \$1,100. Thus it appears that the present day salary earner must take a drastic cut in his standard of living after his productive years or find another way of providing for his old age. O'NEILL, *op. cit. supra* note 11, at 17-19.